IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-476

MICHIGAN OIL COMPANY, A MICHIGAN CORPORATION,
Petitioner,

vs.

NATURAL RESOURCES COMMISSION AND SUPERVISOR OF WELLS AND PIGEON RIVER COUNTRY ASSOCIATION,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MICHIGAN

BRIEF IN OPPOSITION

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OPINIONS BELOW

Petitioner's Appendix omits the concurring opinion of Justice Kavanagh in the Michigan Supreme Court decision. *Michigan Oil Co. v. Natural Resources Commission,* 406 Mich. 1, 34 (1979). *See* Petitioner's App. A.[1] This opinion is reprinted in the Appendix to the Natural Resources Commission's Brief in Opposition.

[1] Citations are to the Petitioner's Appendix.

QUESTIONS PRESENTED

This case involves no substantial federal question and turns on state court interpretation of state statutes, decided against Petitioner at four levels of administrative and judicial review.

STATEMENT OF THE CASE[2]

This case arises from a business gamble that Petitioner made and lost. In 1968, the State of Michigan sold oil and gas leases covering over one-half million acres on state lands in Michigan's northern lower peninsula at an average price of $2.60 per acre. Nearly 60,000 of these acres are in the Pigeon River Country State Forest. The Forest is the last wild, undeveloped large area in the lower peninsula. It is the home of many species of wildlife, including elk, bear, bobcat, beaver, woodcock, eagle and osprey.

The lease sale contemplated that the state would subsequently determine whether or not to grant permits to drill for oil and gas on the leased land. Granting these permits required the Department of Natural Resources (DNR) to find as a matter of fact under the Michigan Oil Conservation Act, Mich. Comp. Laws §319.1 *et seq.*, that "waste" would not result from drilling operations.

In the lands covered by the lease sale, some permits were granted and some were denied. One of the permits that was denied in 1971 was for a 40-acre site in Corwith Township, Otsego County, under

[2] Petitioner relies on several "facts" in its Petition that are completely irrelevant to this Court's review of the Petition. Refusal by the Michigan Department of Natural Resources (DNR) to extend Petitioner's lease following denial of Petitioner's Motion for Rehearing before the Michigan Supreme Court is not part of the record in the instant proceeding. *See* App. N, pp. A192-A193. This refusal, at most, is the subject of a separate action by Petitioner. Second, the list of "well activity", App. M, pp. A187-A191, is extra-record matter. Third, the map reproduced between pages 22 and 23 of the Petition is similarly not found anywhere in the record and, in any event, does not illuminate any matters at issue in this proceeding.

Lease No. 9686 (App. L), then owned by Petitioner's predecessor in interest.

This permit was denied because drilling at the site would cause "waste" prohibited by the Oil Conservation Act. This denial was not appealed.

Petitioner, *because* this permit was denied, bought an interest in the lease under a "farm-out agreement." Under this agreement, Petitioner would receive an assignment of the lease *if* it could obtain a drilling permit from the state and *if* it could drill a commercial producing well at the 40-acre site known as Corwith 1-22.

Petitioner gambled that "waste" under the Oil Conservation Act would be interpreted in Petitioner's favor and the state would issue a drilling permit. The DNR denied Petitioner's application for a permit because the Oil Conservation Act prohibited the DNR from issuing a permit if "waste" would result. Respondent Pigeon River Country Association intervened at the subsequent hearing before the DNR to oppose Petitioner's application for a drilling permit.

The DNR's interpretation of the Oil Conservation Act was affirmed by every Michigan court to which Petitioner appealed. These courts declared, solely as a matter of state law, that Petitioner had speculated that the Oil Conservation Act would be interpreted in its favor when it entered into the farm-out agreement. Petitioner's gamble presents an interesting question of the interpretation of "waste" under state law, but involves constitutionally insignificant issues.

REASONS FOR DENYING THE WRIT

The Writ should be denied because this case presents no substantial federal question. The decision of the Michigan Supreme Court rests on an interpretation of the Michigan Oil Conservation Act and the Michigan Department of Conservation Act, Mich. Comp. Laws §299.1 *et seq.*, which require a showing in a proceeding to

obtain an oil drilling permit that no "waste" will occur. That interpretation is binding on this Court. *Adderley v. Florida*, 385 U.S. 39, 46 (1966).

The Supervisor of Wells denied Michigan Oil's application to drill on the Corwith 1-22 site in the Pigeon River Country State Forest. He found, as a matter of state law, that "waste" would occur since the proposed drilling would seriously damage animal life as well as spoil surrounding state lands. The Michigan Natural Resources Commission (NRC), the Ingham County Circuit Court, the Michigan Court of Appeals and the Michigan Supreme Court all affirmed the denial on the ground that Petitioner had not complied with the Michigan Oil Conservation and Department of Conservation Acts. The only disagreement in the Michigan courts was over the interpretation of "waste". These court decisions under the Oil Conservation Act and the Department of Conservation Act rested on an adequate and independent state ground. This Court will not review a state court decision which is based on an adequate, independent state ground. *Herb v. Pitcairn*, 324 U.S. 117, 125 (1945).

A. Denial of a Drilling Permit Is Not an Unconstitutional Taking of Property.

Michigan Oil has no property interest cognizable under the Fifth and Fourteenth Amendments to the Constitution.[3] Its interests under the lease were entirely contingent upon the grant of a drilling permit by the state. Michigan Oil obtained its potential future interests in the lease in a "farm-out agreement" with express

[3] Petitioner makes the extraordinary claim (Petition p. 17; App. N, pp. A192-A193) that the DNR's refusal to extend the lease (subsequent to the denial of rehearing by the Michigan Supreme Court) is retrospectively incorporated in its property interest that is claimed to be taken. The lease expired by its own terms in 1978. The most that Petitioner can challenge in this Court is the decision of the Michigan Supreme Court. But the DNR's decision not to extend the lease is not part of the judgment sought to be reviewed, as well as not being part of the record below.

knowledge that the state had denied a drilling permit to Michigan Oil's predecessor in interest. The farm-out agreement provided that Michigan Oil would receive an assignment of the lease upon the *condition precedent* that the state would issue a drilling permit.

Petitioner's interest is a non-freehold contingent future interest based on the exercise of the state's police power and a gamble that the courts would interpret "waste" under state law favorably to Petitioner. The Ingham County Circuit Court found:

> "Indeed, Mr. Orr, President of Michigan Oil, testified that he learned of the State Corwith in question through his capacity as a member of the Oil and Gas Advisory Board of the Supervisor of Wells (Tr. 215), and he further testified that he knew of the prior refusals of a permit when Michigan Oil purchased the lease (Tr. 217) and indeed it was purchased *because* a permit had previously been denied (Tr. 217). In other words, Michigan Oil took a chance and lost." App. F, p. A104 (emphasis in original)

Michigan Oil entered the transaction with specific knowledge that the state had authority to deny drilling permits at particular sites.

Michigan Oil has no vested rights in a drilling permit, since the DNR has an express statutory duty to deny a permit upon a finding that the drilling would cause unnecessary damage to the environment by "surface waste". Mich. Comp. Laws §§319.23, 319.2(l)(2) (defining "waste"). If such a finding is made, no drilling permit comes into existence. Thus, the very thing that Petitioner claims to be a property right is conditioned upon an exercise of the police power.

The lease by its terms does not grant a vested right to drill:

> "'H' This lease shall be subject to the rules and regulations of the Department of Conservation now or hereafter in force relative to such leases, all of which rules and regulations are made a part and condition of this lease; . . . ." App. L, p. A186

This fact distinguishes *Mobil Oil Corp. v. Kelley*, 353 F. Supp. 582 (S.D. Ala. 1973), cited by Petitioner at p. 17, in which the subject lease granted a right to drill. *Id.* at 585. Likewise *Union Oil Co. of California v. Morton*, 512 F.2d 743 (9th Cir. 1975), relied on by Petitioner at p. 16, is distinguishable because the lease there conferred vested rights. *Id. at 750.*

Michigan Oil had no "reasonable expectations" in a compensable property interest. This Court stated the applicable principle in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124-125 (1978):

> "[T]his Court has dismissed 'taking' challenges on the ground that, while the challenged government action caused economic harm, it did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes."

There is no constitutionally recognized "reasonable expectation" in a reasonable exercise of the police power. If Michigan Oil bought anything, it bought an investment speculation that the state would exercise the police power in its favor or that the state courts would interpret state law favorable to it. That risk is the nature of Petitioner's business. Michigan Oil cannot claim that there was a taking, since there was no loss.

Petitioner's reliance on *United States v. Causby*, 328 U.S. 256 (1946), is totally inapposite. *Causby* turned on the physical appropriation of the landowner's property. *Causby* and the associated inverse condemnation cases all deal with physical invasion of property and an easement taken for that intrusion. The regulation involved here in no way contemplates or imposes such an easement.

B. Denial of a Drilling Permit Is Not an Unconstitutional Impairment of Contract.

Michigan Oil claims that the DNR's refusal to issue a drilling permit on Corwith 1-22 is an impairment of contractual obligations

in violation of U.S. Const. Art. I, §10. But Michigan Oil has no rights under the state lease until it obtains a drilling permit. Michigan Oil has no contract that provides that it will receive a drilling permit. There is no contract in this case that is violated by state action.

The contract rights held by Petitioner were acquired expressly subject to state law (Para. H of the Lease, App. L, p. A186) which required denial of the drilling permit to prevent waste or destruction of the state's resources. The Contract Clause "does not operate to obliterate the police power of the States". *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 (1978). Petitioner has never denied that the DNR's denial of its drilling permit was a necessary exercise of the police power under Michigan law. The state cannot enter a contract with Petitioner to exercise the police power favorably to Petitioner.

C. Denial of a Drilling Permit Did Not Deny Petitioner Equal Protection Under the Law.

Petitioner's equal protection claim is as insubstantial as its takings and contract impairment claims.[4] Petitioner attempts to show that the DNR was obligated to issue all drilling permits in the Pigeon River State Forest area once it had issued one permit. But the question is one of fact whether "waste" will occur at any particular drilling site. Having granted any oil drilling permits in the Pigeon River State Forest area, the DNR could use any knowledge gained about "waste" caused by this earlier drilling to deny future permits. The DNR's denial of a drilling permit to Petitioner was a legitimate exercise of the police power that meets the minimum standard of "rationality". *City of New Orleans v. Dukes*, 427 U.S. 297 (1976); *Railway Express Agency v. City of New York*, 336 U.S. 106 (1949).

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[4] Petitioner has manufactured an extra-record diagram (Petition, pp. 22-23) and *ex parte* facts (App. M) to inflate its equal protection claim.

D. Michigan Oil Was Not Denied Due Process By the Natural Resources Commission Ruling That "Unnecessary" Damage Under the Oil Conservation Act Included Damage to the Environment.

Petitioner claims that it was denied due process because it had no notice that "unnecessary" damage under the Oil Conservation Act included damage to the environment. Petitioner claims it was therefore precluded from offering rebuttal evidence on this issue. Petitioner's claim is disingenuous, since Petitioner specifically argued at length at the hearing before the DNR examiner that drilling under the permit would not cause environmental damage. App. J, p. 121.

Michigan Oil is barred from raising this due process claim in its Petition. The Petitioner's Statement of Facts nowhere shows where this question was timely and properly raised in the state courts to preserve the question for Supreme Court review. Sup. Ct. R. 23(1)(f).

Petitioner waives federal claims if they are not preserved at the first opportunity in state court proceedings. The Petition implicitly admits (Petition p. 24) that Petitioner's first opportunity to raise the issue of notice was in the Ingham County Circuit Court on appeal from the NRC ruling. But Petitioner neglected to raise this due process and notice claim until it filed its Petition for Rehearing before the Michigan Supreme Court. *See* App. C, pp. A49-A52.

Finally, Petitioner's claimed inability to submit rebuttal evidence is refuted by the facts. Michigan Oil put on a purported wildlife expert, Dr. Manthy, to testify regarding the impact of drilling on wildlife. *See* App. J, pp. A148-A149, A165. Petitioner can hardly now be heard to say that it did not have an opportunity to rebut the DNR's evidence that the drilling at Corwith 1-22 would damage the environment.

CONCLUSION

None of the constitutional claims asserted in the Petition present a substantial federal question. For the foregoing reasons, Respondent Pigeon River Country Association requests that this Court deny Michigan Oil's Petition for Writ of Certiorari to the Supreme Court of the State of Michigan.

Respectfully submitted,

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